

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Northern Illinois Gas Company )  
d/b/a Nicor Gas Company )  
 ) Docket No. 08-0363  
Proposed general increase in rates, and )  
revisions to other terms and conditions )  
of service. )

Surrebuttal Testimony of

**GERALD P. O'CONNOR, FCCA**

Senior Vice President Finance and Strategic Planning  
Nicor Gas Company

November 5, 2008

**OFFICIAL FILE**

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1    **I.       INTRODUCTION**

2    **Q.       Please state your name and business address.**

3    A.       Gerald P. O'Connor, 1844 Ferry Road, Naperville, Illinois 60563.

4    **Q.       By whom and in what position are you employed?**

5    A.       I am the Senior Vice President of Finance and Strategic Planning for Nicor Inc. and  
6           Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor Gas" or the  
7           "Company").

8    **Q.       Are you the same Gerald P. O'Connor that provided direct and rebuttal testimony**  
9           **in this matter?**

10   A.       Yes.

11   **II.       PURPOSE OF TESTIMONY**

12   **Q.       What is the purpose of your surrebuttal testimony in this proceeding?**

13   A.       The purposes of my surrebuttal testimony are to respond to the rebuttal testimony of:

14           (1)   Illinois Commerce Commission (the "Commission" or "ICC") Staff ("Staff")  
15                witness David Brightwell regarding his recommendations for Rider CUA and  
16                Rider EEP. (Brightwell Reb., Staff Ex. 25.0);

17           (2)   Staff witness Peter Lazare regarding his recommendations on the use of riders.  
18                (Lazare Reb., Staff Ex. 20.0);

19           (3)   Attorney General ("AG") and Citizens Utility Board ("CUB") (collectively  
20                "AG/CUB") witness Scott Rubin regarding his recommendations on the use of  
21                riders generally and his recommendations for four of Nicor Gas' proposed riders  
22                in this proceeding: Rider UEA, Rider CUA, Rider VBA and Rider QIP. (Rubin  
23                Reb., AG/CUB Ex. 5.0); and

(4) Staff witnesses Dianne Hathhorn (Hathhorn Reb., Staff Ex. 15.0) and David Sackett (Sackett Reb., Staff Ex. 24.0) regarding their testimony relating to affiliate interest transactions and affiliate access to Nicor Gas facilities.

### III. SUMMARY OF CONCLUSIONS

**Q. What is the conclusion of your surrebuttal testimony?**

A. I provide support for and conclude that each of the following riders proposed by the Company is necessary to address a specific business condition facing Nicor Gas both now and in the future:

- **Uncollectible Expense:** Rider 26, Uncollectible Expense Adjustment (“Rider UEA”);
- **Natural Gas Used by Nicor Gas:** Rider 27, Company Use Adjustment (“Rider CUA”);
- **Volume Balancing Adjustment:** Rider 28, Volume Balancing Adjustment (“Rider VBA”);
- **Energy Efficiency Plan Expenses:** Rider 29, Energy Efficiency Plan (“Rider EEP”); and
- **Infrastructure Replacement Program:** Rider 30, Qualifying Infrastructure Plant (“Rider QIP”).

I also provide support for and conclude that Nicor Gas affiliate transactions are conducted in accordance with existing Commission approvals and in compliance with applicable Commission rules.

45    **IV.    ITEMIZED ATTACHMENTS**

46    **Q.    Are you sponsoring any schedules?**

47    A.    Yes. In addition to my surrebuttal testimony, which has been labeled as Nicor Gas  
48       Exhibit 46.0, I am sponsoring Nicor Gas Exhibits 46.1 through 46.3. I will discuss these  
49       exhibits later in my testimony.

50    **V.    OTHER NICOR GAS WITNESSES**

51    **Q.    Do other Nicor Gas witnesses also respond to the rebuttal testimony of Staff and**  
52       **Intervenors regarding the Company's proposed riders?**

53    A.    Yes. On rebuttal, numerous Nicor Gas witnesses responded to the direct testimony of  
54       Staff and Intervenors. (*See* Nicor Gas Ex. 27.0, 3:45-4:59). On surrebuttal, Nicor Gas  
55       witness Robert R. Mudra will discuss the relationship between the Company's customer  
56       charges and Rider VBA. (Mudra Sur., Nicor Gas Ex. 48.0). Nicor Gas witness Kristine  
57       J. Nichols will provide further support for Rider EEP. (Nichols Sur., Nicor Gas  
58       Ex. 47.0). Nicor Gas witness Anthony R. McCain will further discuss Rider QIP  
59       benefits. (McCain Sur., Nicor Gas Ex. 39.0). Nicor Gas witness Jeff D. Makholm, Ph.D.  
60       will discuss whether there is a relationship between the proposed riders and the  
61       Company's rate of return. (Makholm Sur., Nicor Gas Ex. 44.0). Finally, Nicor Gas  
62       witness Steven M. Fetter will address Staff witness Lazare's views regarding the  
63       proposed riders. (Fetter Sur., Nicor Gas Ex. 36.0).

64 **VI. OVERVIEW OF PROPOSED RIDERS**

65 **Q. Please summarize why Nicor Gas is requesting approval of five new riders.**

66 A. As discussed in my direct and rebuttal testimony, Nicor Gas is proposing each new rider  
67 for several reasons. For example, Nicor Gas proposes Riders UEA and CUA to respond  
68 to significant year-to-year volatility in natural gas prices, which has had a substantial  
69 negative impact on the Company's opportunity to recover its gas-price related costs for  
70 operations and the level of its uncollectible expense. In addition, Nicor Gas proposes to  
71 introduce, through Riders VBA and EEP, a rate design that breaks the direct link between  
72 delivery volumes and the Company's recovery of fixed costs, which will allow the  
73 Company to propose and support a funding mechanism for energy efficiency programs.  
74 Finally, Nicor Gas proposes Rider QIP to establish an appropriate cost recovery  
75 mechanism for certain additional capital investments in a timely fashion to facilitate  
76 Nicor Gas' ongoing replacement of its old cast iron main and copper services.

77 **VII. EXPENSE RECOVERY RIDERS (RIDERS UEA AND CUA)**

78 **Q. What expense related riders is Nicor Gas proposing in this proceeding?**

79 A. Nicor Gas is proposing Rider UEA, which would provide for timely recovery of the  
80 volatile and significant cost associated with bad debt. Nicor Gas also is proposing Rider  
81 CUA, which would provide for timely recovery of the volatile and significant effects of  
82 changes in the price of natural gas used by the Company in the normal course of its  
83 business operations.

84 **Q. Whose testimony will you be addressing with respect to the expense recovery riders?**

85 A. I will respond to rebuttal testimony provided by Staff witness Lazare (Lazare Reb., Staff  
86 Ex. 20.0) and AG/CUB witness Rubin (Rubin Reb., AG/CUB Ex. 5.0).

87 **Q. Does Nicor Gas agree with Mr. Lazare's arguments opposing Nicor Gas' proposed**  
88 **expense recovery riders?**

89 A. No. Mr. Lazare argues that approval of the two proposed expense recovery riders would  
90 "further the interests of shareholders at the expense of ratepayers." (Lazare Reb., Staff  
91 Ex. 20.0, 5:93-94). He conveniently fails to note that both expense riders are designed to  
92 be symmetrical, so that if company use expense or uncollectible expense is less than the  
93 level approved in this case, ratepayers have an opportunity to secure the benefits of those  
94 cost reductions without waiting for a future rate case.

95 **Q. Has Mr. Lazare responded to the fact that the impacts of natural gas prices are (a)**  
96 **significant in terms of Nicor Gas' ability to recover its allowed costs, (b) volatile, and**  
97 **(c) largely outside the control of management?**

98 A. No.

99 **Q. Has Mr. Lazare addressed Nicor Gas' inability to recover or refund the impact of**  
100 **higher or lower costs related to volatile gas prices than those allowed in a rate case,**  
101 **between rate cases and in the absence of Riders CUA and UEA?**

102 A. No.

103 **Q. Does Nicor Gas agree with AG/CUB witness Rubin's characterization of Riders**  
104 **UEA and CUA as representing 6% of the average residential customer's bills and**

105       **raising “\$21.2 million per year for Nicor”? (Rubin Reb., AG/CUB Ex. 5.0, 15:313-**  
106       **20).**

107     A.     No. As displayed in Nicor Gas Exhibit 27.1, the impact of high and volatile gas costs in  
108             2007 meant Nicor Gas under-recovered its allowed operating costs by almost \$21  
109             million, and had these riders been in effect, the recovery of these costs would have raised  
110             average residential customers’ annual charges by 1%, not 6% as Mr. Rubin suggests. To  
111             assert, as Mr. Rubin has done, that Nicor Gas would raise \$21.2 million per year from  
112             Riders UEA and CUA is misleading. As stated previously, Nicor Gas is unable to  
113             forecast long range gas prices with certainty, and consequently is unable to forecast the  
114             financial impact of Riders UEA and CUA prospectively.

115     **Q.     How does Nicor Gas respond to the following statement by Mr. Rubin:**  
116             **“Mr. O’Connor states that Riders UEA and CUA by themselves (that is, just two of**  
117             **the new riders the Company has proposed) would increase Nicor’s net income by**  
118             **almost 10% annually”? (Rubin Reb., AG/CUB Ex. 5.0, 15:329-32).**

119     A.     Mr. Rubin mischaracterizes my rebuttal testimony. I did not say approval of Riders UEA  
120             and CUA would increase the Company's net income by 10% annually. The illustration  
121             provided in my rebuttal demonstrated the comparative effect the riders would have had  
122             between ratepayers and Nicor Gas, had they been in place in 2007. I provided no future  
123             projection because the future price of gas is uncertain. Rather, the purpose of these  
124             proposed riders is to provide Nicor Gas a fair opportunity to recover its allowed costs and  
125             not to increase its net income. The impact of the expense riders is symmetrical.  
126             Approval of both of these riders would permit Nicor Gas a fair opportunity to recover its  
127             actual costs should gas prices rise and provide refunds to ratepayers when gas prices fall.



128 **Q. Will the approval of Riders UEA and CUA somehow improve Nicor Gas'**  
129 **profitability as claimed by AG/CUB witness Mr. Rubin? (Rubin Reb. AG/CUB**  
130 **Ex. 5.0, 15:332).**

131 A. No. Both riders are designed only to permit recovery of costs incurred, not improve  
132 Nicor Gas' profitability. Again, Mr. Rubin conveniently fails to note that both expense  
133 riders are designed to be symmetrical, so that if company use expense or uncollectible  
134 expense is less than the level approved in this case, ratepayers have an opportunity to  
135 secure the immediate benefit of refunds without waiting for such a possibility in a future  
136 rate case.

137 **Q. Has Mr. Rubin responded to the fact that the impacts of natural gas prices are (a)**  
138 **significant in terms of Nicor Gas' ability to recover its allowed costs, (b) volatile, and**  
139 **(c) largely outside the control of management?**

140 A. No.

141 **Q. Has Mr. Rubin addressed Nicor Gas' inability to recover the increase in costs**  
142 **related to volatile gas prices or refund the decrease in costs related to volatile gas**  
143 **prices between rate cases?**

144 A. No.

145 **A. RIDER 26: UNCOLLECTIBLE EXPENSE ADJUSTMENT**

146 **Q. Please briefly describe Rider UEA.**

147 A. Proposed Rider UEA provides for timely recovery of the volatile and significant cost  
148 associated with bad debt. It would allow for either a reduction or increase in charges to  
149 customers based on the difference between the amount of uncollectible expense approved

by the Commission in this proceeding and the actual amount incurred by the Company on an annual basis. The proposed Rider UEA provides that no adjustments would be made if the difference between the rate case amount and actual expense falls within a 5% "dead-band" around the rate case amount.

**Q. Which Staff or Intervenor witnesses have addressed Rider UEA?**

A. Other than AG/CUB witness Rubin's general statements discussed above, Staff witness Lazare is the only witness who addresses Rider UEA. (Lazare Reb., Staff Ex. 20.0).

**Q. Does Mr. Lazare oppose Nicor Gas' proposed Rider UEA?**

A. Yes. Mr. Lazare questions whether Nicor Gas has an incentive to manage the uncollectible process outside of the proposed 5% dead band. He ignores my rebuttal testimony regarding cash management as a significant incentive to manage uncollectible expense both within and outside the proposed dead band. (O'Connor Reb., Nicor Gas Ex. 27.0, 13:256-60). Importantly, he does not disagree with my argument that the dead band provides a significant incentive to manage the uncollectible process within the proposed dead band. Given that Mr. Lazare's sole concern is the question of the Company's incentives to continue to try to lower the uncollectible expense, which are more than amply shown in my testimony, the Commission should approve Rider UEA.

**Q. From a policy perspective, why should the Commission approve Rider UEA?**

A. Uncollectible expense is a significant cost to the Company and is largely dictated by natural gas prices, a factor that is not within the Company's control. Natural gas prices are volatile, which, in turn, means that the level of uncollectible expense for the test year

likely will not be predictive of the level of uncollectible expense that will be experienced in subsequent years.

Rider UEA is designed to be fair and equitable to both Nicor Gas and its customers. It provides Nicor Gas a reasonable opportunity to recover its actual uncollectible costs and, through the dead-band feature, also creates strong incentives for Nicor Gas to do all it can to manage those costs effectively. Rider UEA also benefits customers by providing them the opportunity to receive a reduction in their bills if uncollectible expense fall below 95% of the amount approved in base rates in the test year.

In summary, the Commission should approve Rider UEA because uncollectible expense costs are suitable for recovery through a rider and the methodology for recovery proposed by Rider UEA is fair and equitable to Nicor Gas and its customers.

**B. RIDER 27: COMPANY USE GAS COST ADJUSTMENT**

**Q. Please briefly describe Rider CUA.**

A. Rider CUA provides for timely recovery of the volatile and significant effects of gas price changes in the cost of natural gas used by the Company in the normal course of its business operations. Rider CUA does not seek recovery of the volume difference of company use gas; instead it seeks recovery or refund of the impact of natural gas price changes on company use expense.

**Q. Staff witness Brightwell and AG/CUB witness Rubin suggest that the Company could recover unusually high gas costs through the amortization of Account 823 expenses. (Brightwell Reb., Staff Ex. 25.0, 3:50-53; Rubin Reb., AG/CUB Ex. 5.0,**

**16:342-57). Does Nicor Gas consider such a mechanism appropriate to protect it and ratepayers from the impact of natural gas prices?**

A. No. The mechanism to which Mr. Brightwell refers permits a utility to amortize substantial cost impacts over a period of years rather than in a single year with Commission approval. (Brightwell Reb., Staff Ex. 25.0, 3:50-53). The mechanism does not provide for either a utility's recovery of costs incurred in excess of the level of company use expense approved in base rates, nor does it refund customers when actual average gas prices are less than the amount included in base rates. Finally, the mechanism applies only to physical gas losses in storage fields (Account 823), and not to other company use gas expenses (Accounts 819 and 932).

**Q. Will amortization of Account 823 expenses improve the Company's net income as asserted by AG/CUB witness Rubin? (Rubin Reb., AG/CUB Ex 5.0, 16:346-57).**

A. No. Mr. Rubin is incorrect. The effect of an amortization would be to positively impact one year, and negatively impact each subsequent year of the amortization period. Other than providing a temporary timing impact, an amortization cannot improve net income. Moreover, Mr. Rubin's amortization proposal fails to allow for refunds to ratepayers when company use gas prices are below those allowed in base rates.

**Q. Staff witness Brightwell now seems to imply that company use gas costs are not significant. (Brightwell Reb., Staff Ex. 25.0, 4:77). Does Nicor Gas agree?**

A. No. Mr. Brightwell concluded that a \$1.00 change in test-year forecasted average price of natural gas appears more significant when compared with the Company's proposed operating income rather than its original cost rate base. (Brightwell Reb., Staff Ex. 25.0,

4:77-82). For example, in 2006, one year after Nicor Gas' last rate case, Docket No. 04-0779 ("2004 Rate Case"), company use expense was \$17.9 million, or almost 91% above the level included in base rates. (O'Connor Dir., Nicor Gas Ex. 12.0, 18:304). The Operating Income impact was a reduction of almost 12%, and Nicor Gas failed to recover its actual costs for 2006.

**Q. Does Nicor Gas agree with Mr. Brightwell's assertion that "Mr. O'Connor's method fails to separate the impact of changes in natural gas prices from the impact of changes in volume"? (Brightwell Reb., Staff Ex. 25.0, 6:130-31).**

A. No. Rider CUA is designed to recover, or refund, the impact of gas price changes to the prices allowed in the most recent rate case only. In simple terms, the formula takes the difference between the actual average gas price incurred in any year and the average price approved in the most recent rate case, and multiplies the result by the volume of company use gas approved in the most recent rate case. The result will either be a refund to ratepayers or a charge under the rider. Rider CUA does not provide for the recovery of any costs associated with higher volumes used.

**Q. Does Nicor Gas agree with Mr. Brightwell's recommendation to "reject Rider CUA on the grounds that it distorts the company's incentive to conserve gas"? (Brightwell Reb., Staff Ex. 25.0, 6:130-31).**

A. No. Because the rider does not provide for recovery of increases associated with volume, the Company continues to have a strong incentive to lower usage to reduce cost just as it has incentives to reduce other costs. Mr. Brightwell ignores the rebuttal testimony of Nicor Gas witness Gary Bartlett, which clearly demonstrates that Nicor Gas' ability to

conserve company use is very limited, with or without Rider CUA. (Bartlett Reb., Nicor Gas Ex. 19.0, 33:736-34:760).

**Q. What is the Company's response to Mr. Brightwell's volatility or coefficient of variation ("CV") analysis of gas prices? (Brightwell Reb., Staff Ex. 25.0, 6:113-7:136).**

A. There is a fundamental misconception contained within Mr. Brightwell's analysis. He has assumed that Nicor Gas consumes company use therms equally over each month of each year. On the contrary, usage varies greatly from month to month, and any average price calculation needs to be weighted in accordance with monthly usage. The attached Nicor Gas Exhibit 46.1 shows the calculation of weighted average price for each of the past eight years, and computes the coefficient of variation at .52, which is a significantly higher number than computed by Mr. Brightwell. As shown on the exhibit, the CV of company use gas prices is almost five times more volatile than for non-commodity related operating and maintenance ("O&M") expenses.

**Q. From a policy perspective, why should the Commission approve Rider CUA?**

A. Company use expense is a significant cost to Nicor Gas and is driven by natural gas prices, a factor that is not within the control of the Company. Natural gas prices, in turn, are volatile, which means that the level of company use expense for the test year likely will not be predictive of the level of company use expense that will be experienced in subsequent years.

Rider CUA is designed to be fair and equitable both to Nicor Gas and its customers. It provides Nicor Gas a reasonable opportunity to recover its actual costs for

company use and, because it only applies to changes in gas prices and not to changes in volumes of company use gas consumed, also creates a strong incentive for Nicor Gas to do all it can to manage those costs effectively. Rider CUA also benefits the Company's customers by providing them a reduction in their bills if gas prices fall below the gas price used to calculate the amount of company use expense included in base rates.

In summary, the Commission should approve Rider CUA because company use expense is suitable for recovery through a rider and the methodology for recovery proposed by Rider CUA is fair and equitable to Nicor Gas and its customers.

**VIII. VOLUME BALANCING ADJUSTMENT AND ENERGY EFFICIENCY RIDERS (RIDERS VBA AND EEP)**

**Q. Please describe Rider VBA and Rider EEP.**

A. Nicor Gas' proposed Rider VBA is a revenue stabilization or "decoupling" mechanism, consistent with similar riders previously approved by the Commission in Peoples Gas' and North Shore Gas' recent rate proceedings. *Peoples Gas*, Docket Nos. 07-0241/07-0242 (consol.), Order at 153 (Feb. 5, 2008) ("Peoples Gas Order"). Nicor Gas' proposed Rider EEP is a funding mechanism for new energy efficiency programs to promote increased conservation by its customers, also consistent with similar riders previously approved by the Commission in the Peoples Gas Order. Together, these two new riders promote increased energy efficiency in a manner that is a "win-win" situation for both Nicor Gas and its customers.

279           **A.       RIDER 28: VOLUME BALANCING ADJUSTMENT**

280   **Q.       Please provide a brief overview of Nicor Gas' proposed Rider VBA.**

281   A.       Rider VBA provides the Company the opportunity to recover its fixed costs as approved  
282           in this proceeding, despite changes in weather or conservation from year to year. The  
283           rider is designed symmetrically in that over collections of revenues are refunded to  
284           customers and under collections are charged to customers.

285   **Q.       Does Nicor Gas agree with AG/CUB witness Rubin that "[r]ather than a complete**  
286           **denial of service, a utility could delay customer connections; change the way it**  
287           **allocates resources to customer connections and restorations, so that customers**  
288           **whose lost revenues cannot be recovered through Rider VBA are given higher**  
289           **priority; and so on"? (Rubin Reb., AG/CUB Ex. 5.0, 17:366-71).**

290   A.       No. Having failed to support his contention in his direct testimony that the Company  
291           might refuse or neglect to provide service following approval of a volume balancing  
292           adjustment rider, Mr. Rubin now raises new and similarly unsubstantiated concerns. He  
293           also fails to recognize that the Company remains accountable for its service obligations to  
294           the Commission and that ratepayers would have recourse in the event of a deterioration of  
295           service.

296   **Q.       Did any other witness object to Rider VBA?**

297   A.       No. Staff witness Burma Jones highlighted an alternative mechanism and she provided  
298           suggested modifications to the Company's proposed Rider VBA. (Jones Dir., Staff  
299           Ex. 3.0, 22:401-27:545). Mr. Mudra responded to Ms. Jones' mechanism in his rebuttal  
300           testimony. (Mudra Reb., Nicor Gas Ex. 29.0). The Company agreed to Ms. Jones'



suggested modifications to the Nicor Gas's proposed Rider VBA. (*Id.*, 53:1107-19).

Based on the Company's response to Mr. Rubin's perverse incentive argument above and Ms. Jones' alternative mechanism, the Company's proposed Rider VBA should be approved as modified by Ms. Jones.

**Q. From a policy perspective, why should the Commission approve Rider VBA?**

A. The Company's existing rate design wherein a substantial portion of its fixed costs are recovered through volumetric charges does not promote energy conservation. Rider VBA is being offered as a four-year pilot program and promotes Nicor Gas' partnership with its customers to achieve greater energy conservation gains. Rider VBA also benefits the Company's customers by providing credits when weather is colder than normal and gas bills are likely to be high.

In summary, the Commission should approve Rider VBA because it is an appropriate rate design solution that balances the promotion of energy conservation with the need to provide the Company with the opportunity to recover its fixed costs.

**B. RIDER 29: ENERGY EFFICIENCY PLAN**

**Q. Please briefly describe Nicor Gas' proposal for Rider EEP.**

A. Nicor Gas' proposed Rider EEP is similar to the energy efficiency rider approved by the Commission in the Peoples Gas Order. Specifically, Nicor Gas proposes establishing an Advisory Board that would have responsibility for designing and operating the Energy Efficiency Plan. Under the plan, Nicor Gas would be a fiscal agent, transferring up to \$13 million per year of customer-supplied funds to vendors for Advisory Board-approved energy efficiency programs.

323 **Q. Staff witness Mr. Brightwell has indicated a number of concerns with the Rider**  
324 **EEP Conservation Stabilization Adjustment (“CSA”): (a) Program Implementers**  
325 **are likely to have an incentive to overstate the therm savings in order to receive**  
326 **approval from the Advisory Board; (b) there is no ex-post evaluation of these**  
327 **projects to determine the accuracy of the ex-ante estimates of therm savings; and**  
328 **(c) management structure gives the Company the ability to determine the projects**  
329 **developed and the level of gas savings that result from the projects. (Brightwell**  
330 **Reb., Staff Ex. 25.0, 9:181-19:403). How does the Company respond to his first**  
331 **concern?**

332 **A.** Any attempt by the Program Implementers to overstate the projected level of therm  
333 savings would be checked by the broadly-based Advisory Board of energy efficiency  
334 experts, which brings the most suitable level of expertise required to objectively assess  
335 each proposed project.

336 **Q. How does Nicor Gas respond to Mr. Brightwell’s second concern that ex-ante and**  
337 **ex-post evaluations should occur?**

338 **A.** Nicor Gas fully supports ex-post or after-the-fact evaluations of projects, including each  
339 project’s success in achieving energy efficiency targets developed by the Advisory  
340 Board. Indeed, the proposed plan calls for such evaluations and for such findings to be  
341 used for future project evaluations.

342 **Q. What is the Company’s response to Mr. Brightwell’s final concern regarding the**  
343 **management structure should CSA be approved?**

344 A. Mr. Brightwell claims that there is potential for abuse because Nicor Gas has the ability  
345 to determine the projects developed and the level of gas savings that result from the  
346 projects. Nicor Gas agrees that it should not, and affirmatively states that it does not,  
347 have the ability to determine the projects developed and the level of gas savings that  
348 result from the projects under the plan's proposed management structure. That is  
349 precisely why Nicor Gas has advocated the governance structure outlined in the  
350 testimony of Nicor Gas witness Kristine Nichols. (See Nichols Dir., Nicor Gas Ex. 13.0).

351 **Q. From a policy perspective, why should the Commission approve Rider EEP?**

352 A. Increased energy efficiency is a worthy public policy goal and it is of great importance to  
353 the Commission, ratepayers and the State of Illinois. Indeed, the only Intervenor with  
354 energy efficiency experience provides testimony supporting the Company's proposed  
355 Rider EEP.

356 Rider EEP and the Company's proposed energy efficiency plan are modeled after  
357 the plan and rider considered and approved by the Commission in the Peoples Gas Order.  
358 Simply stated, Rider EEP is an appropriately structured mechanism to provide funding  
359 for the development of energy efficiency programs in the Company's service territory  
360 and should be approved by the Commission.

361 **IX. RIDER 30: QUALIFIED INFRASTRUCTURE PLANT**

362 **Q. Please provide a brief overview of Nicor Gas' proposed Rider QIP.**

363 A. Nicor Gas' proposed Rider QIP provides for the return of and on investment arising from  
364 the Company's program to replace cast iron main and copper services. In developing its  
365 Rider QIP, the Company considered guidance from the Commission regarding the criteria

for any rider proposal seeking to recover certain costs associated with such capital investments outside of a rate case, and also the requirements set forth for infrastructure plant surcharges in Section 9-220.2 of the Act and Part 656 of the Commission's rules. 220 ILCS 5/9-220.2; 83 Ill. Adm. Code Part 656.

**Q. Does Nicor Gas agree with Staff witness Lazare's contention that expected rate payer benefits arising from approval of Rider QIP are "tenuous"? (Lazare Reb., Staff Ex. 20.0, 9:199).**

A. No. As outlined in my direct and rebuttal testimonies, as well as the direct and rebuttal testimonies of Nicor Gas witness Anthony McCain, there are several benefits to ratepayers. (See Nicor Gas Exs. 12.0, 27.0, 5.0 and 20.0 respectively). In summary, as set forth in the testimony of Mr. McCain, these include: (1) immediate O&M cost reduction of \$6,000 per mile of main; (2) a future improvement in leak rates and related cost avoidance that is supported by historic improvements arising from the Company's risk-based approach to infrastructure improvements; (3) improved customer service and lower long term costs arising from relocation of inside meters and the related improvement of meter reading accuracy; (4) reduced training and improved staffing efficiencies upon completion of the project, together with related cost savings; and (5) improved leak investigation efficiency and effectiveness by eliminating lower pressure systems.

**Q. Does the Company agree with AG/CUB witness Rubin's assessment that Rider QIP is not cost effective? (Rubin Reb., AG/CUB Ex. 5.0, 18:382-83).**

A. No. Mr. Rubin failed to consider the un-quantified but considerable benefits that will accrue to ratepayers in the future as outlined above.

389 **Q. From a policy perspective, why should the Commission approve Rider QIP?**

390 A. While the current rate of replacement does not pose a threat to safety or reliability of  
391 service, the Company's cast iron main and copper services are old, inefficient and costly  
392 to maintain. For operational purposes, Nicor Gas would like to replace all of these  
393 remaining facilities at an accelerated pace. Accordingly, the Commission should approve  
394 Rider QIP because it will improve the efficiency and reliability of the Company's  
395 distribution system. It also will pass on reduced O&M costs to customers on a timely  
396 basis.

397 **X. AFFILIATE TRANSACTIONS AND ACCESS TO NICOR GAS FACILITIES**

398 **Q. How does the Company respond to the comments of Staff witness Hathhorn**  
399 **regarding affiliate transactions? (Hathhorn Reb., Staff Ex. 15.0, 19:401-04).**

400 A. Nicor Gas properly applies its tariffs, and properly charges affiliates for services,  
401 including billing services, provided pursuant to tariff or under the terms of the  
402 Commission-approved Operating Agreement between Nicor Gas and its affiliates (the  
403 "Operating Agreement"). (Nicor Gas Ex. 46.3). Moreover, Nicor Gas' interactions with  
404 affiliates are proper and in conformance with the Commission's rules. The surrebuttal  
405 testimony of Nicor Gas witness James M. Gorenz specifically addresses the revenue  
406 requirement adjustment relating to affiliated billing services proposed in Ms. Hathhorn's  
407 rebuttal testimony. (Gorenz Sur., Nicor Gas Ex. 45.0).

408 Nicor Gas fully understands that it is within the Commission's discretion to order  
409 investigations of its regulated entities. It is Nicor Gas' position that there is no evidence  
410 within this proceeding that warrants such an investigation. However, Nicor Gas does not

object to the Commission initiating an investigation to examine the Operating Agreement, to address those issues raised in Ms. Hathhorn's testimony, and those issues raised in Staff witness Sackett's rebuttal testimony.

**Q. With regard to transactions with its affiliates, does Nicor Gas have policies and procedures to assure regulatory compliance?**

A. Yes. Nicor Gas has Company Policy Order A-54 "Illinois Commerce Commission Regulation of Transactions between Nicor Gas and its Affiliates," which sets forth the procedures for transacting business with its affiliates. (See Nicor Gas Ex. 46.2). Nicor Gas also has in place procedures for review and approval of proposed transactions with affiliates by its Chief Compliance Officer. In addition, Nicor Gas employees who interact with affiliates receive training about dealing with such affiliates and the requirements of Part 550 of the rules of the Commission. 83 Ill. Adm. Code Part 550. Those policies and procedures require that transactions with affiliates are accounted for properly in accordance with the requirements of the Operating Agreement, which the Commission approved in Docket No. 00-0537.

**Q. Are there internal controls in place to provide assurance that these policies and procedures are complied with? If so, please describe them.**

A. Yes. The Company has a number of internal controls in place to provide such assurance, including:

- Employee Training – Upon hire, Nicor Gas trains its new employees as to its inter-company billing policies, and approximately every two years employees dealing with affiliates must complete on-line training regarding such policies.

- 433 • Policy Reminders – Twice a year, a memo is sent to managers company-wide,  
434 reminding them of Nicor Gas' policies and the need to be diligent in billing  
435 affiliates.
- 436 • Billing Reminders – Each month, a memo is sent to all employees that regularly  
437 bill affiliates, reminding them of the need to bill affiliates for that month.
- 438 • Monitoring – Quarterly, the Accounting Internal Control department interviews a  
439 sample of employees and examines their billings to affiliates to ensure policy  
440 compliance.
- 441 • Internal Audits – Bi-annually, the Internal Audit Department conducts a  
442 comprehensive audit of inter-company billing practices. The results of such  
443 audits are provided to the Commission.
- 444 • Certifications – Each quarter, all managers and officers of Nicor Inc. and its  
445 wholly owned affiliates complete a survey in which they are required to state  
446 whether they are aware of any processes or activities being performed that are not  
447 in accordance with the Company's policies.

448 **Q. Does Nicor Gas have Commission authorization for each service that it provides to**  
449 **an affiliate and does it provide such service in compliance with such authorization?**

450 A. Yes.

451 **Q. Does Nicor Gas have Commission authorization for each service that it receives**  
452 **from an affiliate and is such service provided to Nicor Gas in compliance with such**  
453 **authorization?**

454 A. Yes.

455 **Q. What are Staff witness Mr. Sackett's comments regarding affiliate access to**  
456 **Company facilities? (Sackett Reb., Staff Ex. 24.0, 47:1028- 52:1126).**

457 A. First, Mr. Sackett raises concerns regarding use of the Nicor Inc. website for advertising  
458 by its non-utility subsidiaries. Second, he raises concerns regarding use of the Nicor Gas

call centers to market affiliate services. Finally, he recommends that any subsequent proceeding as recommended by Staff witness Ms. Hathhorn, consider a warranty service known as Gas Line Comfort Guard.

**Q. Does Nicor Gas have any comments regarding use of the Nicor Inc. website to market affiliate services?**

A. Mr. Sackett contends that all Customer Select suppliers should be provided with the same type of link on the Nicor Inc. website that is provided to Nicor Advanced Energy, a subsidiary of Nicor Inc. that is a Customer Select supplier. (Sackett Reb., Staff Ex. 24.0, 49:1070-50:1081). Mr. Sackett acknowledges that the website is owned by the Company's parent, Nicor Inc., not by Nicor Gas, but contends that the use of the website should be investigated because it is referenced on the Company's gas bills and customers can navigate from the pages involving Nicor Gas services to pages relating to products and services offered by non-regulated affiliates of Nicor Gas. (*Id.*, 48:1039-49:1062).

The www.nicor.com website (with its associated domain names) is used by Nicor Inc. to provide information about itself and its subsidiaries to many different constituencies, including investors and potential investors, employees, business partners, vendors and suppliers, and customers and potential customers. What Mr. Sackett ignores is the need for public companies like Nicor Inc. to maintain a clear, comprehensive and user-friendly website to communicate to the public concerning the operations of its various business segments. For instance, the Securities and Exchange Commission is increasingly looking to websites as an important disclosure tool for the companies it regulates. Nicor Inc. has responsibility and potential exposure for information it disseminates via its website. Understandably, it has no interest in having its operations,



financial results, brand names or corporate goodwill confused with non-affiliated businesses.

The Company recognizes that the use of the Nicor Inc. website by Nicor Gas as a means to provide customers with information about its utility operations is subject to the Commission's approval. In fact, such usage by Nicor Gas is authorized under, and complies with, the requirements of the Commission-approved Operating Agreement. Mr. Sackett does not contend otherwise. As Mr. Sackett also appears to recognize, the use by Nicor Inc. of its website as a means of providing information about its non-regulated operations is not subject to regulation by the Commission. (Sackett Reb., Staff Ex. 24.0, 49:1057-58).

**Q. What is the Company's response to Staff witness Mr. Sackett's assertion regarding use of the Nicor Gas call center to market affiliate services?**

A. Mr. Sackett considers it unfair to other providers of gas commodity and related products and services that Nicor Gas provides call center marketing services to an affiliate. (Sackett Reb., Staff Ex. 24.0, 50:1088-89). In fact, the call center services that Nicor Gas provides to Nicor Services are authorized under the Operating Agreement, and Nicor Gas charges Nicor Services appropriately for these services. Mr. Sackett does not contend otherwise.

**Q. Mr. Sackett recommends that the Commission investigate whether Gas Line Comfort Guard should be subject to rate regulation. (Sackett Reb., Staff Ex. 24.0, 50:1117-19). What is Nicor Gas' response?**

503 A. Nicor Gas provides customer solicitation, billing and repair services to Nicor Services for  
504 Gas Line Comfort Guard. Nicor Gas is authorized to provide these services for Nicor  
505 Services under the Operating Agreement, which allows for the provision of billing  
506 services, customer solicitation and operational services (*see* Sections 2.2 (a), (d) and (e)  
507 of the Operating Agreement), and charges Nicor Services appropriately for these  
508 services. While recognizing that Gas Line Comfort Guard is a product that is not  
509 provided by Nicor Gas, Mr. Sackett nonetheless recommends that the Commission  
510 investigate whether the product should be subject to rate regulation. I am at a loss to  
511 understand how Mr. Sackett could conclude that a product offering by a non-utility  
512 affiliate of Nicor Gas might be made subject to rate regulation by the Commission.

513 **XI. CONCLUSION**

514 **Q. Does that conclude your surrebuttal testimony?**

515 A. Yes.



Nicor Gas

EFFECTIVE:	January 17, 2005	POLICY ORDER:	A-54
SUPERSEDES:	Policy Order A-54 effective November 1, 2001		
REFERENCES:	Illinois Public Utilities Act; Part 550 of Ill.C.C. Regulations; Operating Agreement between Nicor Gas and Affiliates; Policy Order L-6	SUBJECT:	Illinois Commerce Commission Regulation of Transactions between Nicor Gas and its Affiliates

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Transactions between gas utilities and their affiliates are subject to regulation by the Illinois Commerce Commission ("Ill.C.C."). With some exceptions, contracts and arrangements between gas utilities and their affiliates must receive the prior consent of the Ill.C.C. In addition, the Illinois Public Utilities Act ("PUA") and Ill.C.C. rules prohibit or restrict certain types of interactions by gas utilities with their affiliates. It is the policy of Nicor Gas to comply fully with these laws and regulations in its interactions with affiliates.

A. The Operating Agreement

The Ill.C.C. has approved an Operating Agreement (the "Operating Agreement") between Nicor Gas and most of its affiliates. Among other things, the Operating Agreement permits Nicor Gas to (i) provide certain types of services to affiliates, (ii) receive certain types of services from affiliates, (iii) make available certain Nicor Gas facilities for use by affiliates, (iv) effectuate the sale of assets and (v) use certain facilities of affiliates. Transactions between Nicor Gas and its affiliates that are permitted by the Operating Agreement may be undertaken without further approval by the Ill.C.C. as long as those services or facilities are provided in the manner outlined in the Operating Agreement and are not prohibited by specific Ill.C.C. rules.

Nicor Gas recognizes the potential benefits from transactions with affiliates that are permitted under the Operating Agreement. Therefore, Nicor Gas may enter into transactions with affiliates that involve provision or receipt of services and use of facilities to the extent provided by the Operating Agreement and not prohibited by specific Ill.C.C. rules.

1. Required charges.

If Nicor Gas is the provider of services or facilities under the Operating Agreement, the applicable affiliates shall generally be charged for the services and facilities at an amount equal to or greater than Nicor Gas' fully distributed cost. If Nicor Gas provides similar services to the general public under an Ill.C.C. approved pricing mechanism, that third-party price should be charged to the affiliate instead of fully distributed cost.

If Nicor Gas is the recipient of services or facilities, Nicor Gas shall generally be charged for services and facilities at an amount equal to or less than the applicable affiliate's fully distributed cost. If the affiliate provides similar services to the general public, and the affiliate receives a substantial portion of its revenue from such transaction with the general public, that third-party price should be charged to Nicor Gas instead of fully distributed cost.

Fully distributed cost includes direct costs, allocated costs, and a charge for indirect costs.

## 2. Facilities

Facilities that may be provided under the *Operating Agreement* include office space and equipment (copy machines, filing cabinets, furniture, etc.), computer equipment and networks (including peripheral devices, storage media and software), communications equipment, vehicles and supplies.

For practical reasons, Nicor Gas will generally own all applicable facilities that are provided under the *Operating Agreement*. For example, Nicor Gas should own all furniture and fixtures in the General Office building. It should also own all computer software and computer equipment that are used by both Nicor Gas and affiliates. The cost of such facilities will be recovered through the charge for indirect costs.

Facilities that are used exclusively by an affiliate should be purchased by or charged directly to the affiliate. Examples include computer software used exclusively for an affiliate's own purposes, and furniture and fixtures in a building rented and used exclusively by an affiliate.

## 3. Services

Services include administrative and management support (executive, accounting, legal, secretarial, tax, treasury, etc.), personnel services, purchasing services, technical (IT) services, operational services, joint purchasing and customer support.

Standard support services that are provided to all Nicor Gas employees will be charged to affiliates via an indirect labor additive. All other services of Nicor Gas employees that are specifically attributable to an affiliate shall be directly charged to the affiliate.

Example: An affiliate desires to design a compensation and benefit package specific to its employees. Since this goes beyond standard personnel services covered by the indirect labor additive, Nicor Gas should directly charge the affiliate for this service.

Example: An affiliate desires computer programming specific to its needs. Since this goes beyond standard information technologies services covered by the indirect labor additive, Nicor Gas should directly charge the affiliate for this service.

Appropriate systems for accumulating hours worked for affiliates and distributing associated charges shall be maintained. Labor charges will reflect the effects of overtime and paid absences.

## 4. Obligation to Provide Facilities or Services

Nicor Gas shall not be obligated to provide facilities or services to its affiliates. Therefore, affiliates are encouraged to consult with Nicor Gas before making decisions that depend on its support.

Example: An affiliate purchases computer software to be used exclusively for its own purposes. To support the software, incremental shared computer equipment such as servers and disk storage is necessary. Nicor Gas is not required to purchase such equipment. In that case, the affiliate may need to acquire its own computer equipment for its exclusive use.

Example: An affiliate purchases computer software utilizing technology that is not supported by Nicor Gas. Nicor Gas is not obligated to acquire the technology or skills necessary to support the affiliate.

B. Authorizations and Compliance Questions

It shall be the responsibility of the Nicor Gas officer in charge of a transaction with an affiliate to ensure that any necessary Ill.C.C. authorization has been obtained and that such transaction is conducted in accordance with such authorization and with requirements of the PUA and Ill.C.C. regulations. If such transaction involves a contract or arrangement to provide or receive service or use of a facility, the Nicor Gas officer shall be responsible to ensure that costs are appropriately accounted for in accordance with this policy.

Questions regarding the requirements of the PUA and Ill.C.C. regulations or interpretation of the Operating Agreement shall be directed to the General Counsel of Nicor Gas. Questions regarding appropriate accounting for costs under the Operating Agreement shall be directed to the Principal Accounting Officer of Nicor Gas. The Accounting Control Department shall review and approve inter-billing pricing matters for each type of transaction.

C. Transactions with Affiliates that are not Covered by the Operating Agreement

As a general rule, contracts and arrangements between Nicor Gas and its affiliates that are not specifically permitted under the Operating Agreement must receive prior Ill.C.C. approval unless the PUA or Ill.C.C. rules provide a specific exception.

Currently, no partially -owned subsidiaries of Nicor Inc. are party to the Operating Agreement. As such, contracts and arrangements between Nicor Gas and such affiliates generally will require prior Ill.C.C. approval.

D. Transactions with Affiliates that are Restricted or Prohibited

The PUA and Ill.C.C. rules prohibit certain types of interactions between gas utilities and their affiliates and impose restrictions on other types.

For instance, the PUA requires prior approval for a gas utility to guarantee obligations of its affiliates. It also prohibits employees of a gas utility from engaging in certain marketing activities on behalf of its affiliates that provide heating, ventilating or air conditioning services within the utility's service territory.


Part 550 of the Ill.C.C. rules (83 I.A.C. Part 550) prohibits or restricts certain activities by a gas utility that might discriminate in favor of its affiliates. Among other things, these rules prohibit the gas utility from (i) providing its affiliates with preferential treatment or advantages in connection with services provided under tariffs or in releasing or transferring interstate pipeline and storage service, (ii) tying utility services to the required purchase of goods or services offered by its affiliates, (iii) providing its affiliates with preferential access to customer billing and usage information or (iv) entering into transactions with its affiliates that subsidize the affiliates.

Part 550 imposes special restrictions on a gas utility's dealings with its affiliates in competition with alternative retail gas suppliers. Generally, these additional restrictions are designed to require these affiliates to function independent of the utility in most respects.

Part 550 also imposes on gas utilities certain recordkeeping and audit requirements with respect to their transactions with affiliates.

E. Related Policies

See Nicor Gas Policy L-6 for additional guidelines applicable to (i) releases of interstate pipeline capacity by Nicor Gas to an affiliate, (ii) purchases of gas by Nicor Gas from an affiliate, (iii) sales of gas by Nicor Gas to an affiliate and (iv) sales of Rate 21 or FERC HUB services by Nicor Gas to an affiliate.

  
\_\_\_\_\_  
Paul Gracey  
Vice President and General Counsel

**OPERATING AGREEMENT**

Dated as of October 25, 2001

Among

NICOR Inc.

Northern Illinois Gas Company

d/b/a Nicor Gas Company

and

Each of the Entities Identified on Exhibit A Hereto



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## OPERATING AGREEMENT

THIS OPERATING AGREEMENT (this "Agreement") is made and entered into as of the \_\_\_\_\_, among NICOR Inc., an Illinois corporation ("NICOR"), Northern Illinois Gas Company, an Illinois corporation doing business as Nicor Gas Company ("Nicor Gas"), and each of the entities identified on Exhibit A hereto, as such Exhibit A may be amended from time to time in accordance with the provisions of this Agreement.

### WITNESSETH:

WHEREAS, the parties are related by virtue of common ownership, directly or indirectly, of their equity securities by NICOR; and

WHEREAS, the parties believe that the central management of certain services, the provision to each other of certain services and facilities, and the transfer of certain property are or may be efficient and cost-effective, and the parties desire to make provision for these and other transactions as between Nicor Gas and a NICOR Entity or Entities;

WHEREAS, the parties are currently signatories to an Operating Agreement approved by the Illinois Commerce Commission in Docket No. 60256;

WHEREAS, this agreement is intended to supercede the Operating Agreement approved in Docket No. 60256.

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants contained herein, the parties hereby agree as follows:

### ARTICLE I

#### Definitions and Interpretation

Section 1.1. *Definitions.* As used in this Agreement, the following terms shall have the respective meanings set forth below unless the context otherwise requires:

"*Acquiring Party*" means a Party who desires to acquire real property, interests in real property, tangible personal property or Intangible Assets from a Selling Party.

"ICC" means the Illinois Commerce Commission.

"*Intangible Assets*" means items, other than tangible assets and real property, for which costs have been incurred to create future economic benefits that may or may not be recorded as assets on the Selling Party's financial statements. Intangible Assets include, but are not limited to, operational knowledge, software or intellectual property derived from internal research and development efforts.

"Party" means each, and "Parties" means all, of the entities who are from time to time a party to this Agreement.

"*Provider*" means a Party who has been requested to, and who is able and willing to, furnish facilities, provide services or both to a Requestor under the terms of this Agreement.

"*Requestor*" means a Party who desires to use facilities, receive services or both, and has requested another Party to furnish such facilities, provide such services or both.

"*Selling Party*" means a Party who is willing to sell and transfer real property, interests in real property, tangible personal property or Intangible Assets to an Acquiring Party.

"*NICOR Entity*" means any of NICOR and the entities identified on Exhibit A hereto, as amended from time to time.

**Section 1.2. Purpose and Intent; Interpretation.** (a) The purposes and intent of this Agreement are to set forth procedures and policies to govern (i) transactions between a NICOR Entity and Nicor Gas, whether such transactions occur directly or indirectly as the end result of a series of related transactions and (ii) the allocation of certain joint service costs. It is not intended to govern transactions between NICOR Entities that do not involve Nicor Gas (although such entities may elect to apply the provisions of this Agreement to specific transactions) or to govern transactions between Nicor Gas and its subsidiaries. This Agreement shall be interpreted in accordance with such purposes and intent.

(b) The headings of Articles and Sections contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. References to Articles, Sections and Exhibits refer to articles, sections and exhibits of this Agreement unless otherwise stated. Words such as "herein," "hereinafter," "hereof," "hereto," "hereby" and "hereunder," and words of like import, unless the context requires otherwise, refer to this Agreement (including the Exhibits hereto).

## ARTICLE II

### Use of Facilities and Services

**Section 2.1. Facilities.** Upon the terms and subject to the conditions of this Agreement, a Requestor may request a Provider or Providers to make available or provide, and, subject to the provisos at the end of this Section, such Provider or Providers may make available or provide to such Requestor, the use of:

(a) facilities, including, without limitation, office space, warehouse and storage space, transportation, repair facilities, manufacturing and production facilities, fixtures and office furniture and equipment;

(b) computer equipment (both stand-alone and mainframe) and networks, peripheral devices, storage media, and software;

(c) communications equipment, including, without limitation, audio and video equipment, radio equipment, telecommunications equipment and networks, and transmission and switching capability;

(d) vehicles, including, without limitation, automobiles, trucks, vans, trailers, railcars, marine vessels, aircraft, transport equipment, material handling equipment and construction equipment; and

(e) machinery, equipment, tools, parts and supplies;

*provided, however, that a Provider shall have no obligation to provide any of the foregoing, considering such factors as the extent that such item or items are not available (either because such Provider does not possess the item or the item is otherwise being used); and provided further, it is understood that a Provider has sole discretion in scheduling the use by a Requestor of facilities, equipment or capabilities so as to avoid interference with such Provider's operations.*

**Section 2.2. Services.** Upon the terms and subject to the conditions of this Agreement, a Requestor may request a Provider or Providers to provide, and, subject to the provisos at the end of this Section, such Provider or Providers may provide to such Requestor:

(a) administrative and management services, including, without limitation, accounting (including, without limitation, bookkeeping, budgeting, forecasting, billing, accounts receivable and accounts payable administration, and financial reporting); audit; executive; finance; cash management (including, without limitation, electronic fund transfers, cash receipts processing, managing short-term borrowings and investments with third parties, and short-term borrowing and investing between Parties to this Agreement subject to the limitations and at the interest rates specified in the Addendum to this Agreement); governmental affairs; insurance; information systems services; investment advisory services; legal; library; record keeping; secretarial and other general office support; real estate management; security holder services; tax; treasury; and other administrative and management services;

(b) personnel services, including, without limitation, recruiting; training and evaluation services; payroll processing; employee benefits administration and processing; labor negotiations and management; and related services;

(c) purchasing services, including, without limitation, preparation and analysis of product specifications, requests for proposals and similar solicitations; vendor and vendor-product evaluations; purchase order processing; receipt, handling, warehousing and disbursement of purchased items; contract negotiation and administration; inventory management and disbursement; and similar services;

(d) operational services, including, without limitation, drafting and technical specification development and evaluation; consulting; engineering; environmental; construction; design; resource planning; economic and strategic analysis; research; testing; training; public and governmental relations; and other operational services; and

(e) customer solicitation, customer support and other marketing-related services, including, without limitation, customer lists and other customer-related information;

*provided, however, that a Provider shall have no obligation to provide any of the foregoing, considering such factors as the extent that it is not capable of providing such service (either because such Provider does not have personnel capable of providing the requested service or the service is otherwise being used); and provided further, it is understood that a Provider has sole discretion in scheduling the use by a Requestor of services so as to avoid interference with such Provider's operations.*

**Section 2.3. Joint Purchasing.** A Party may also request that another Party or Parties enter into arrangements to effect the joint purchase of goods or services from third parties; *provided, however, that if Nicor Gas is so requested to enter into and agrees to participate in such arrangements, it shall do so only if its fully distributed cost for such goods or services is not thereby increased. In the event that any such arrangements are established, one Party may be designated as, or serve as, agent for the other Parties to the arrangement and may administer the arrangement (including billing and collecting amounts due the vendor(s)) for the other Parties.*

**Section 2.4. Agreements, Etc.** A Provider and Requestor may evidence their agreement with respect to the availability, provision or use of the facilities, services and activities described in this Article II by entering into an agreement, lease, license or other written memorandum or evidence; *provided such agreement, lease, license or other written memorandum or evidence shall not contain terms inconsistent with this Agreement; and further provided that this Section 2.4 shall not be deemed to require any such agreement, lease, license or other written memorandum or evidence.*

### ARTICLE III Asset Sales

**Section 3.1. Real Property Transfers.** Upon the terms and subject to the conditions of this Agreement, an Acquiring Party may purchase from a Selling Party, and the Selling Party may sell to the Acquiring Party, real property or interests in real property.

**Section 3.2. Tangible Personal Property.** Upon the terms and subject to the conditions of this Agreement, an Acquiring Party may purchase from a Selling Party, and the Selling Party may sell to the Acquiring Party, tangible personal property. This Section 3.2 shall not apply to joint purchasing arrangements (and the transactions thereunder) entered into pursuant to Section 2.3 of this Agreement.

**Section 3.3. Intangible Assets.** An Acquiring Party may enter into an agreement with a Selling Party to purchase, and the Acquiring Party may purchase from the Selling Party and the Selling Party may sell to the Acquiring Party pursuant to such agreement, Intangible Assets.

**Section 3.4. NICOR Stock.** Upon the terms and subject to the conditions of this Agreement, NICOR may issue and sell to Nicor Gas shares of NICOR Common Stock for the sole purpose of enabling Nicor Gas to meet its obligations to its directors and employees in respect of compensation (it being understood that Nicor Gas would cause any shares so purchased and received to be reissued to such directors and employees in payment of such compensation obligations).

Section 3.5. *Agreements, Etc.* An Acquiring Party and a Selling Party may evidence their agreement with respect to the sale of real property and/or tangible personal property described in Sections 3.1 or 3.2 by entering into an agreement or other written memorandum or evidence; *provided* such agreement or other written memorandum or evidence shall not contain terms inconsistent with this Agreement; and *further provided* that this Section 3.5 shall not be deemed to require any such agreement or other written memorandum or evidence.

#### ARTICLE IV Charges; Payment

Section 4.1. *Charges.* (a) Charges for assets sold and transferred under Sections 3.1, 3.2 and 3.4 shall be determined in accordance with the provisions of Section 5.1(a); charges for the use of facilities, equipment, capabilities or services under Sections 2.1 and 2.2 shall be determined in accordance with Section 5.1(b); and charges for assets sold and transferred under Section 3.3 shall be determined in accordance with the provisions of Section 5.1(c). By acquiring real property, interests therein, tangible personal property or Intangible Assets in accordance with the provisions of Article III, an Acquiring Party shall be deemed to have agreed to pay, and shall pay, to the Selling Party the charge determined therefor in accordance with Section 5.1(a) or, in the case of Intangible Assets, Section 5.1(c). By requesting the use of facilities, equipment, capabilities and/or services, a Requestor shall be deemed to have agreed to pay, and shall pay, to the Provider or Providers the charge determined therefor in accordance with Section 5.1(b).

(b) Charges related to arrangements under Section 2.3 for the joint purchase of goods or services shall be determined in accordance with Section 5.1(a), in the case of asset transfers, and Section 5.1(b), in the case of services and overhead, administrative and other costs.

Section 4.2. *Accounting.* Each Party shall maintain adequate books and records with respect to the transactions subject to this Agreement and shall establish unique account numbers in its general ledger system which shall be used to record the costs to be apportioned to the other Parties. Each Party shall be responsible for maintaining internal controls to ensure the costs associated with transactions covered by this Agreement are properly and consistently allocated and billed in accordance with the terms and provisions of this Agreement.

Section 4.3. *Invoicing, Payment.* Invoicing and payment for the facilities and services specified in Article II, the asset sales specified in Article III or the joint services costs specified in Section 5.3(a) shall be as follows:

(a) for the use of facilities, equipment or capabilities specified in Section 2.1 or the provision of services specified in Section 2.2, a Provider shall invoice the Requestor on a monthly basis for the charges therefor as provided in Section 4.1(a), and such invoices shall be payable within thirty days of receipt;

(b) for joint purchasing arrangements specified in Section 2.3, a Party participating in any such arrangement shall be invoiced for charges as provided in Section 4.1(b), which invoices will be payable according to the terms set by the vendor(s) providing the purchased goods or services, or if a Party has been selected to administer such arrangement, pursuant to invoices rendered by such Party or the vendor of the goods or services, which invoices will be payable no later than thirty days of receipt;

(c) for the sale of real property or interests in real property specified in Section 3.1, the Acquiring Party shall pay the charges therefor as provided in Section 4.1(a) to the Selling Party upon the closing of the sale and transfer of such real property or interests therein;

(d) for the sale of tangible personal property specified in Section 3.2, or intangible assets specified in Section 3.3, the Selling Party shall invoice the Acquiring Party for the charges therefor as provided in Section 4.1(a), and such invoices shall be payable within thirty days of receipt;

(e) for the transfer of NICOR Common Stock specified in Section 3.4, Nicor Gas shall pay the charges therefor as provided in Section 4.1(a) and such payment shall be made to NICOR concurrently with the issuance and delivery of the shares of such stock; and

(f) for joint service costs under Section 5.3(a), NICOR shall invoice the other Parties for such costs as provided in Section 5.3(c), and such invoices shall be payable within thirty days of receipt.

Late payments shall bear a rate of interest representing NICOR's cost of funds, as determined by contacting NICOR's commercial paper dealers, but shall in no event exceed the then-effective rate of interest announced by Bank of America Illinois in Chicago, Illinois. The interest shall be based on the period of time that the payment is late.

## ARTICLE V

### Cost Apportionment Methodology

**Section 5.1. General Principles.** The following general principles shall be used in setting charges for transactions between Nicor Gas and NICOR Entities:

(a) **Sales of Assets.** Asset sales between Nicor Gas and a NICOR Entity shall be charged by the Selling Party to the Acquiring Party at: (i) the fair market value of the transferred asset, as evidenced by (1) the prevailing price for which the same or similar assets are offered for sale to the general public by the Selling Party (e.g., for Nicor Gas, the tariffed charge or other pricing mechanism approved by the ICC) or, if no such prevailing price exists, (2) the price at which nonaffiliated vendors offer the same or similar assets for sale by reference to quoted market prices, independent appraisals or other objectively determinable evidence or, if no such fair market value is objectively or practicably determinable, (ii) the historical cost of the asset to the Selling Party, less all applicable valuation reserves.



(b) Use of Facilities or Services.

(i) Facilities or services provided by Nicor Gas to a NICOR Entity shall be charged by the Provider to the Requestor at: (1) the prevailing price for which the facility or service is provided for sale to the general public by the Provider (i.e., the tariffed rate or other pricing mechanism approved by the ICC) or, if no such prevailing price exists, (2) an amount equal to or greater than the fully distributed cost (determined as provided in Section 5.2) incurred by the Provider in providing such facility or service to the Requestor.

(ii) Facilities or services provided by a NICOR Entity to Nicor Gas shall be charged by the Provider to the Requestor at: (1) the prevailing price for which the facility or service is provided for sale to the general public by the Provider (i.e., the price charged to nonaffiliates if such transactions with nonaffiliates constitute a substantial portion of such NICOR Entity's total revenues from such transactions) or, if no such prevailing price exists, (2) an amount not to exceed the fully distributed cost (determined as provided in Section 5.2) incurred in providing such facility or service.

(c) Sales of Intangible Assets. Intangible Asset sales between Nicor Gas and a NICOR Entity shall be charged by the Selling Party to the Acquiring Party (i) under a mechanism to reflect the fair market value of the asset as determined by an appraisal or other fair market value study or, if no such fair market value is objectively or practicably determinable, (ii) at the fully distributed cost incurred to purchase or develop the asset, adjusted to reflect imputed amortization of, if applicable, any carrying costs on the unrecorded asset.

Costs shall be charged to a Party in accordance with these general principles using either a direct charge or an allocation methodology. Costs of assets or services specifically attributable to a Party should be charged directly to such Party. Joint and common costs not specifically attributable to a Party should be charged to the appropriate Parties based on specific allocation methodologies. The Parties intend to develop and implement a set of guidelines to address applications of the foregoing general principles.

**Section 5.2. Fully Distributed Costs.** Costs charged on a fully distributed cost basis shall reflect the amounts of direct labor, direct materials and direct purchased services associated with the related asset or service as provided in subsections (a) and (b). These amounts shall be increased by a portion of indirect costs to reflect labor, administrative and general and other overhead amounts as provided in subsection (c).

(a) Direct Costs. Costs incurred that are specifically attributable to a Party shall be directly charged to the appropriate account.

(i) Direct Labor: Amounts of direct labor charged to a Party shall be based on actual direct labor, reflecting the effects of overtime and nonproductive time.

For most employees, direct labor shall be charged to a Party pursuant to the following methodology: an employee shall report each month the number of hours incurred in performing activities for such Party. Based on the time reported each month, the regular, predetermined account distribution for the employee shall be adjusted to reflect the distribution of direct labor charges to the appropriate affiliate function.

Some individuals, departments or organizations may provide a recurring, predictable level of services to a Party or Parties. For these individuals, departments or organizations, at a minimum annual reviews shall be performed to determine a normal distribution of time to such Party or Parties. The distribution percentages derived from such reviews shall then be used to allocate time with respect to each month. Significant deviations of actual activity from these predetermined percentages shall be reported and shall result in adjustments to the predetermined distribution of direct labor charges to the affiliate accounts.

Overtime shall be reflected in the direct labor rates charged to a Party. For bargaining unit employees, direct labor shall be charged based on the base and overtime pay amounts under a Party's collective bargaining agreements. Likewise, for non-bargaining employees who are compensated for overtime, direct labor shall be charged based on the base pay amounts incurred for such employees, including overtime. For management employees not compensated for overtime, direct labor charged to affiliates shall be adjusted, on a departmental or organizational basis, to reflect estimated overtime incurred based on an overtime review performed annually.

All direct labor charges shall be increased by a factor to reflect nonproductive time. The nonproductive time factor shall be developed based on a review of actual nonproductive time incurred for the previous year. The nonproductive time factor reflects time incurred for vacations, holidays, disability, jury duty and other paid absences.

(ii) Direct Materials and Purchased Services. Amounts incurred for materials or purchased services directly attributable to a Party shall be charged directly to the appropriate account for that Party.

(b) Allocated Costs. Costs incurred that are not specifically attributable to a Party but that have joint benefit to two or more Parties shall be charged to the appropriate Parties based on specified allocation methodologies. The allocation methodologies used shall be reasonably based on cost causative measures to ensure an equitable allocation among such Parties.

(c) Indirect Costs. The direct and allocated costs apportioned to a Party or Parties shall be increased to reflect indirect labor, administrative and general and other overhead amounts. These indirect costs are not specifically identifiable or attributable to the direct costs incurred on behalf of a Party.

All direct labor charges apportioned to a Party (either apportioned directly or using an allocation methodology) shall be increased by a loading factor to reflect indirect labor-driven costs. For each Party, this loading factor shall be determined annually based on actual indirect labor-driven charges incurred during the prior year as a percentage of total direct labor charges incurred in that year. The labor loading shall include payroll taxes; medical, dental and vision insurance costs; pension and other

postretirement health care benefits costs; incentive compensation plan costs; employee savings plans costs; training costs; other employee benefits; the employee benefits department costs; communications and computer support and facilities costs.

Facilities costs include buildings and related property, such as equipment, machinery, furniture and fixtures, and related services, such as mail delivery and library services. These indirect charges shall include an amount to reflect the cost of such assets (e.g., depreciation, operations, maintenance, utilities, insurance, real estate taxes, etc.) and, for owned assets or assets leased under capital leases, a return equal to the rate of return on rate base most recently authorized for Nicor Gas by the ICC.

**Section 5.3. Costs Charged to/from NICOR.** NICOR shall maintain unique account numbers in its general ledger system: Consolidated Pool accounts (as described in Section 5.3(a)) and Unallocated Pool accounts (as described in Section 5.3(b)). All costs incurred by NICOR and not directly charged to another Party and all costs apportioned and billed to NICOR by other Parties shall be charged to one of these two types of accounts.

(a) **Consolidated Pool Costs.** The Consolidated Pool accounts shall be charged with costs related to activities that jointly benefit all of the Parties. Each month, the costs accumulated in the Consolidated Pool shall be apportioned and billed to the Parties (other than NICOR) using a two-factor formula methodology. A representative listing of the types of Nicor services for which costs shall be charged to the Consolidated Pool is as follows:

Accounting	Forecasting
Auditing	Governmental Affairs
Branding and Other Marketing	Information Systems
Budgeting	Investor Relations
Corporate Planning	Legal
Corporate Secretary's Office	Risk Management
Executive Services	Shareholder Services
Financial Reporting	Tax Administration
Finance	

(b) **Unallocated Costs.** The Unallocated accounts shall be charged with costs that have been determined as not appropriate for apportionment by NICOR to the other Parties. These costs primarily relate to NICOR's diversification and divestiture activities.

(c) **Two-Factor Formula Methodology.** Monthly, costs charged to the Consolidated Pool shall be apportioned and billed by NICOR to the other Parties based on a two-factor formula methodology. Under this approach, each such Party wholly owned by NICOR (other than non-operating Parties) is allocated and billed for a portion of the total costs in the Consolidated Pool based on an average of such Party's gross payroll and total asset amounts relative to the corresponding averages for the other wholly owned operating Parties. To adjust for seasonality in operations, the gross payroll amounts used in this allocation shall be the twelve-month-ended amounts through the prior quarter-end. The total asset amount shall reflect the month-end balance from the prior quarter ended. Non-operating affiliates are those that exist solely for the purpose of enabling Nicor Inc. to perform its corporate function and which do not engage in the active management or oversight of any

enterprise doing business with third parties. For majority-owned Parties that are not wholly owned, the two-factor formula shall consider only the proportional ownership share of such Party's gross payroll and total assets. Affiliates that are not controlled by Nicor Inc. are precluded from becoming Parties to this Agreement. For purposes of this Agreement, control exists when Nicor Inc. holds, directly or indirectly, more than 50 percent of the voting rights of the entity's common stock or more than 50 percent of the seats on the board of directors or other oversight committee.

*Section 5.4. Allocations Among Parties Other Than Nicor Gas.* Nothing in this article, or any other article, shall limit or restrict the rights of Parties other than Nicor Gas to allocate costs among themselves, so long as it does not adversely impact Nicor Gas, such as by increasing Nicor Gas' costs. If a Nicor Entity charges Nicor Gas based upon its fully distributed costs, and such costs include any intercompany charges from affiliates, such intercompany charges shall be determined in accordance with the cost apportionment methodology described in this Agreement

#### ARTICLE VI Limitations of Liability

*Section 6.1. No Warranties For Facilities or Services.* Each Party acknowledges and agrees that any facilities, equipment or capabilities made available, and any services provided, by a Provider to a Requestor hereunder, are so made available or provided WITHOUT ANY WARRANTY (WHETHER EXPRESS, IMPLIED OR STATUTORY AND NOTWITHSTANDING ANY ORAL OR WRITTEN STATEMENT BY A PARTY'S EMPLOYEES, REPRESENTATIVES OR AGENTS TO THE CONTRARY) WHATSOEVER. ALL SUCH WARRANTIES (INCLUDING, WITHOUT LIMITATION, THE WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) ARE HEREBY DISCLAIMED AND EXCLUDED.

*Section 6.2. Limited Warranties For Asset Sales.* (a) Except as provided in Section 6.2(b), each Party acknowledges and agrees that any real property, interests in real property, tangible personal property or Intangible Assets sold and transferred in accordance with Article III is so sold and transferred WITHOUT ANY WARRANTY (WHETHER EXPRESS, IMPLIED OR STATUTORY AND NOTWITHSTANDING ANY ORAL OR WRITTEN STATEMENT BY A SELLING PARTY'S EMPLOYEES, REPRESENTATIVES OR AGENTS TO THE CONTRARY) WHATSOEVER. ALL SUCH WARRANTIES (INCLUDING, WITHOUT LIMITATION, THE WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) ARE HEREBY DISCLAIMED AND EXCLUDED.

(b) In connection with a sale and transfer of real property, interests in real property, tangible personal property, Intangible Assets or NICOR stock pursuant to Article III, the Selling Party shall be deemed to have represented and warranted to the Acquiring Party that: (i) title conveyed is good, (ii) conveyance of such title is authorized and rightful, and (iii) the title so conveyed is free and clear of all liens, claims, encumbrances or security interests of persons or entities claiming by or through the Selling Party, except, in the case of this clause (iii), as the Acquiring Party and the Selling Party may otherwise agree.

**Section 6.3. No Partnership.** The Parties acknowledge and agree that this Agreement does not create a partnership between, or a joint venture of, a Party and any other Party. Each Party is an independent contractor and nothing contained in this Agreement shall be construed to constitute any Party as the agent of any other Party except as expressly set forth in Section 2.3.

**Section 6.4. No Third Party Beneficiaries.** This Agreement is intended for the exclusive benefit of the Parties hereto and is not intended, and shall not be deemed or construed, to create any rights in, or responsibilities or obligations to, third parties.

## ARTICLE VII

### Term

**Section 7.1. Term.** This Agreement will be effective on the date it is approved by the ICC and shall continue, unless terminated as provided in Section 7.2.

**Section 7.2. Termination.** Any Party may terminate this Agreement as to it by providing at least 30 days prior written notice to the other Parties of the effective date of such termination. In addition, this Agreement shall terminate as to a Party upon the date that NICOR determines that such Party shall no longer be a party to this Agreement and shall automatically terminate as to a Party upon the date that NICOR ceases, directly or indirectly, to own equity securities in such Party. Any such termination shall not affect the terminating Party's accrued rights and obligations under this Agreement arising prior to the effective date of termination or its obligations under Section 9.4.

## ARTICLE VIII

### Confidential Information

Each Party shall treat in confidence all information which it shall have obtained regarding the other Parties and their respective businesses during the course of the performance of this Agreement. Such information shall not be communicated to any person other than the Parties to this Agreement, except to the extent disclosure of such information is required by a governmental authority. If a Party is required to disclose confidential information to a governmental authority, such Party shall take reasonable steps to make such disclosure confidential under the rules of such governmental authority. Information provided hereunder shall remain the sole property of the Party providing such information. The obligation of a Party to treat such information in confidence shall not apply to any information which (i) is or becomes available to such Party from a source other than the Party providing such information, or (ii) is or becomes available to the public other than as a result of disclosure by such Party or its agents.

## ARTICLE IX

### Miscellaneous

**Section 9.1. Entire Agreement; Amendments.** Upon its effectiveness as provided in Section 7.1, this Agreement shall constitute the sole and entire agreement among the Parties with

respect to the subject matter hereof and shall supersede all previous agreements, proposals, oral or written, negotiations, representations, commitments and all other communications between some or all of the Parties. Except as provided in Section 9.2 with respect to new Parties and except that NICOR may amend Exhibit A to this Agreement to delete any terminated Party, this Agreement shall not be amended, modified or supplemented except by a written instrument signed by an authorized representative of each of the Parties hereto.

**Section 9.2. New Parties.** Any other entity which is or may become an affiliate of NICOR or any of the other Parties to this Agreement may become a party to this Agreement by executing an agreement adopting all of the terms and conditions of this Agreement. Such agreement must be signed by NICOR in order to become effective, but need not be signed by any other Party to this Agreement. Upon such execution, such entity shall be deemed to be a Party and shall be included within the definition of "Party" for all purposes hereof, and Exhibit A shall be amended to add such entity. Nicor Gas shall notify the ICC by means of an informational filing each time a new Party becomes eligible to receive or provide services and facilities under this Agreement. This informational filing should include the name and business purpose of the Party and its relationship to Nicor Gas.

**Section 9.3. Assignment.** This Agreement may not be assigned by any Party without the prior written consent of NICOR.

**Section 9.4. Access to Records.** During the term of this Agreement and for a period of seven years after the expiration or termination of this Agreement as to a Party, such Party shall have reasonable access to and the right to examine any and all books, documents, papers and records which pertain to services and facilities provided by the other Parties under this Agreement to such Party, and such Party shall provide access to, and the opportunity to examine, all such records which pertain to services and facilities provided to the other Parties under this Agreement by such Party. Each Party shall maintain all such records for a period of seven years after expiration or termination of this Agreement as to such Party. In addition, during the term of this Agreement and for a period of seven years after the expiration or termination of this Agreement as to a Nicor Entity, the ICC shall have access to the books and records of such Nicor Entity as they relate to transactions between such Nicor Entity and Nicor Gas to the extent allowed under Section 7-101 of the Illinois Public Utilities Act and subject to Section 5-108 of the Illinois Public Utilities Act.

**Section 9.5. Partial Invalidity.** Wherever possible, each provision hereof shall be interpreted in such manner as to be effective and valid under applicable law, but in case any one or more of the provisions contained herein shall, for any reason, be held to be invalid, illegal or unenforceable in any respect, such provision shall be ineffective to the extent, but only to the extent, of such invalidity, illegality or unenforceability without invalidating the remainder of such invalid, illegal or unenforceable provision or provisions or any other provisions hereof, unless such a construction would be unreasonable. In the event that it is determined that the charges for a particular transaction covered by this Agreement were not determined properly for any reason, such determination and/or finding shall not affect the validity of such transaction; *provided, however*, that if the transaction involved Nicor Gas and a NICOR Entity, NICOR (or, if NICOR so determines, such NICOR Entity) shall pay to or reimburse Nicor Gas, or Nicor Gas shall pay to or reimburse such NICOR Entity, as the case may be, for the difference between the amount that was charged in connection with the transaction and the charge that is determined to be proper under the provisions of Article V.

**Section 9.6. Waiver.** Failure by any Party to insist upon strict performance of any term or condition herein shall not be deemed a waiver of any rights or remedies that such Party may have against any other Party nor in any way affect the validity of this Agreement or any part hereof or the right of such Party thereafter to enforce each and every such provision. No waiver of any breach of this Agreement shall be held to constitute a waiver of any other or subsequent breach.

**Section 9.7. Governing Law.** This Agreement shall be governed by, construed and interpreted pursuant to the laws of the State of Illinois.

IN WITNESS WHEREOF, the Parties have each caused this Agreement to be executed by a duly authorized representative as of the day and year first above written.

NICOR INC.

By: Philip S. Cali  
Name: Philip S. Cali  
Title: Executive Vice President Operations

NORTHERN ILLINOIS GAS COMPANY

By: Philip S. Cali  
Name: Philip S. Cali  
Title: Executive Vice President Operations

BIRDSALL, INC.

By: George M. Behrens  
Name: George M. Behrens  
Title: Director


TROPIC EQUIPMENT LEASING INC.

By: George M. Behrens  
Name: George M. Behrens  
Title: Director and Vice President


TROPICAL BAHAMAS LTD.

By: George M. Behrens  
Name: George M. Behrens  
Title: Director


NICOR ENERGY VENTURES COMPANY

By:  ✓  
Name: Daniel R. Dodge  
Title: Vice President

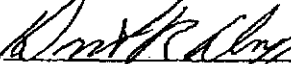
NICOR ENERGY MANAGEMENT SERVICES COMPANY

By:   
Name: Philip S. Cali  
Title: Director and President

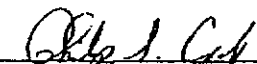
NICOR ENERGY SERVICES COMPANY

By:   
Name: Philip S. Cali  
Title: Director and President


NICOR ENERGY SOLUTIONS INC.

By:  ✓  
Name: Daniel R. Dodge  
Title: Vice President

ENERCHANGE L.L.C.

By:   
Name: Philip S. Cali  
Title: Vice President

NICOR NGV CORP.

By:   
Name: Philip S. Cali  
Title: Director and President

NICOR TECHNOLOGIES INC.

By:  ✓  
Name: Daniel R. Dodge  
Title: Vice President

NICOR HOME SERVICES, L.L.C.

By:  ✓  
Name: Daniel R. Dodge  
Title: Vice President



NICOR HORIZON, INC.

By: Philip S. Cali  
Name: Philip S. Cali  
Title: Director and President

NICOR POWER HOLDING COMPANY

By: Daniel R. Dodge ✓  
Name: Daniel R. Dodge  
Title: Vice President

NICOR ROCKY ROAD COMPANY

By: Daniel R. Dodge ✓  
Name: Daniel R. Dodge  
Title: Vice President

NICOR OIL & GAS CORPORATION

By: Kathleen L. Halloran  
Name: Kathleen L. Halloran  
Title: Vice President, Controller & Treasurer  
Director

NICOR NATIONAL INC.

By: Kathleen L. Halloran  
Name: Kathleen L. Halloran  
Title: Director and Treasurer

NICOR MINING INC.

By: Kathleen L. Halloran  
Name: Kathleen L. Halloran  
Title: Vice President, Controller & Treasurer  
Director

### **FIRST AMENDMENT TO OPERATING AGREEMENT**

This First Amendment to Operating Agreement ("First Amendment") is made and entered into as of the 13th day of September, 2004.

#### **WITNESSETH**

Whereas, Nicor Inc. ("NICOR"), Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor Gas") and each of the other signatories hereto are parties to that certain Operating Agreement dated as of October 25, 2001 (the "Original Operating Agreement"); and

Whereas, by Order issued in Docket No. 02-0581 and effective June 15, 2004 (the "Order"), the Illinois Commerce Commission adopted 83 Ill. Administrative Code Part 340 (Money Pool Agreements); and


Whereas, the Parties desire to amend the Original Operating Agreement solely for the purpose of complying with the requirements of the Order and updating Exhibit A to the Original Operating Agreement to reflect a current list of the Parties.

NOW THEREFORE, in consideration of the foregoing and the mutual covenants contained herein, the Parties hereby agree as follows:

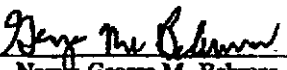
1. Unless otherwise expressly defined herein, capitalized terms used herein shall have the meanings assigned to them in the Original Operating Agreement.
2. The term "Agreement" as used in the Original Operating Agreement and this First Amendment shall be deemed to mean the Original Operating Agreement as amended by this First Amendment.
3. The Addendum to the Original Operating Agreement is hereby deleted in its entirety and the new Addendum attached to this First Amendment is substituted in lieu thereof.
4. Exhibit A to the Original Operating Agreement is hereby deleted in its entirety and the new Exhibit A attached to this First Amendment is substituted in lieu thereof.
5. Except as amended hereby, the Original Operating Agreement shall continue in full force and effect in accordance with its terms.

IN WITNESS WHEREOF, the Parties have each caused this First Amendment to be executed by a duly authorized representative as of the day and year first above written.


NICOR INC.

By:   
Name: George M. Behrens  
Title: Vice President and Treasurer


NORTHERN ILLINOIS GAS COMPANY

By:   
Name: George M. Behrens  
Title: Vice President and Treasurer

BIRDSALL, INC.

By:   
Name: Thomas M. Black  
Title: Senior Vice President


TROPIC EQUIPMENT LEASING INC.

By:   
Name: George M. Behrens  
Title: Vice President


TROPICAL BAHAMAS LTD.

By:   
Name: Thomas M. Black  
Title: President


NICOR ENERGY VENTURES  
COMPANY

By:   
Name: Paul C. Gracey, Jr.  
Title: Secretary


NICOR ENERGY MANAGEMENT  
SERVICES COMPANY

By:   
Name: Paul C. Gracey, Jr.  
Title: Secretary


NICOR ENERGY SERVICES COMPANY

By:   
Name: Paul C. Gracey, Jr.  
Title: Secretary


NICOR ENERGY SOLUTIONS INC.

By:   
Name: Paul C. Gracey, Jr.  
Title: Secretary

NICOR ENERCHANGE, L.L.C. (F/K/A  
ENERCHANGE, L.L.C.)

By:   
Name: Paul C. Gracey, Jr.  
Title: Secretary


NICOR TECHNOLOGIES INC.

By:   
Name: Paul C. Gracey, Jr.  
Title: Secretary

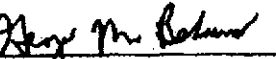
NICOR HOME SERVICES, L.L.C.

By:   
Name: Paul C. Gracey, Jr.  
Title: Secretary


NICOR HORIZON, INC.

By:   
Name: George M. Behrens  
Title: Treasurer

NICOR POWER HOLDING COMPANY

By:   
Name: George M. Behrens  
Title: Treasurer


NICOR ROCKY ROAD COMPANY

By:   
Name: Paul C. Gracey, Jr.  
Title: Secretary


NICOR OIL & GAS CORPORATION

By:   
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Title: Secretary

NICOR NATIONAL INC.

By:   
Name: Paul C. Gracey, Jr.  
Title: Secretary

NICOR MINING INC.

By:   
Name: Paul C. Gracey, Jr.  
Title: Secretary

NICOR PURCHASING, L.L.C.

By: George M. Behrens  
Name: George M. Behrens  
Title: Treasurer

NICOR SOLUTIONS, L.L.C.

By: George M. Behrens  
Name: George M. Behrens  
Title: Treasurer

NI-GAS EXPLORATION, INC.

By: Paul C. Gracey, Jr.  
Name: Paul C. Gracey, Jr.  
Title: Secretary

Revised  
September 13, 2004

**ADDENDUM**  
Short-term Borrowing and Investment between Parties

Cash advances made by Nicor Gas to NICOR Inc. pursuant to this Agreement shall be in accordance with the following terms and in accordance with 83 Ill. Administrative Code Part 340 (Money Pool Agreements) as adopted by Illinois Commerce Commission (the "ICC") Order effective June 15, 2004 in Docket No. 02-0581, as the same may be amended or modified by the ICC from time to time:

(a) To the extent that Nicor Gas possesses excess cash and no outstanding short term borrowings, cash advances can be made to Nicor Inc. to the extent that it continues to meet the requirements of Section 340.40(b)(1); and

(b) the interest rate on cash advances from Nicor Gas to NICOR Inc. shall be calculated at the higher of (i) the interest rate at which NICOR Inc. could have borrowed the funds pursuant to an existing bank credit agreement(s) or commercial paper facility(ies) entered into between NICOR Inc. and an unaffiliated third party or parties, or (ii) the rate the utility would have earned on existing short term investment accounts maintained during the same period.

Cash advances made by a NICOR Entity to Nicor Gas pursuant to this Agreement shall be in accordance with the following terms and in accordance with 83 Ill. Administrative Code Part 340 (Money Pool Agreements) as adopted by ICC Order effective June 15, 2004 in Docket No. 02-0581, as the same may be amended or modified by the ICC from time to time:

(a) The balance of cash advances shall not at any time exceed the unused balance of funds actually available to Nicor Gas under Nicor Gas' existing bank credit agreement(s) or commercial paper facility(ies) entered into between Nicor Gas and an unaffiliated third party or parties; and

(b) the interest rate on cash advances from NICOR Entity to Nicor Gas shall be calculated at the lower of (i) the interest rate at which Nicor Gas could have borrowed the funds pursuant to an existing bank agreement(s) or commercial paper facility(ies) entered into between Nicor Gas and an unaffiliated third party or parties, or (ii) the NICOR Entity's actual interest cost, including issuance costs, for the funds obtained or used to provide the cash advance to Nicor Gas.

SECOND AMENDMENT TO  
OPERATING AGREEMENT

This Second Amendment to Operating Agreement ("Second Amendment") is made and entered into as of the 7th day of February, 2007.

WITNESSETH

WHEREAS, Nicor Inc. ("NICOR"), Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor Gas") and each of the other signatories hereto are parties to that certain Operating Agreement dated as of October 25, 2001 (the "Original Operating Agreement") as amended by that certain First Amendment to Operating Agreement dated as of September 13, 2004 (the "First Amendment") (the Original Operating Agreement as amended by the First Amendment is herein referred to as the "Currently Effective Operating Agreement"); and

WHEREAS, by Order issued in Docket No. 02-0581 and effective June 15, 2004 (the "Money Pool Order"), the Illinois Commerce Commission (the "ICC") adopted 83 Ill. Administrative Code Part 340, Money Pool Agreements; and

WHEREAS, the parties to the Original Operating Agreement entered into the First Amendment for the purposes of complying with the Money Pool Order and, by Order issued in Docket No. 04-0629 on December 15, 2004 (the "First Amendment Order"), the ICC approved the First Amendment; and

WHEREAS, the First Amendment and the First Amendment Order permitted Nicor Gas to loan funds to NICOR on the condition, among others, that NICOR continued to meet the eligibility criterion set forth in Section 340.40(b)(1) of the ICC regulations; and

WHEREAS, the ICC regulations issued pursuant to the Money Pool Order also would allow Nicor Gas to loan funds to NICOR as long as NICOR met the eligibility criteria set forth in either Section 340.40(b)(2) or Section 340.40(b)(3) of the ICC regulations; and

WHEREAS, the parties desire to amend the Currently Effective Operating Agreement solely to allow Nicor Gas to loan funds to NICOR as long as NICOR continues to meet the eligibility criterion set forth in Section 340(b)(1), (2) or (3) of the ICC regulations.

NOW THEREFORE, in consideration of the foregoing and the mutual covenants contained herein, the Parties hereby agree as follows:

1. Unless otherwise expressly defined herein, capitalized terms used herein shall have the meanings assigned to them in the Currently Effective Operating Agreement.
2. The term "Agreement" as used in the Currently Effective Operating Agreement and this Second Amendment shall be deemed to mean the Currently Effective Operating Agreement as amended by this Second Amendment.



3. The initial clause (a) of the Addendum to the Currently Effective Operating Agreement is hereby deleted in its entirety and the following new initial clause (a) is substituted in lieu thereof:

"(a) To the extent that Nicor Gas possesses excess cash and no outstanding short term borrowings, cash advances can be made to NICOR Inc. to the extent that it continues to meet the requirements of Section 340.40(b)(1), (2) or (3); and"

4. Except as amended hereby, the Currently Effective Operating Agreement shall continue in full force and effect in accordance with its terms.

IN WITNESS WHEREOF, the Parties have each caused this Second Amendment to be executed by a duly authorized representative as of the day and year first above written.

NICOR INC.

By: 

Name: Gerald P. O'Connor  
Title: Vice President Finance  
and Treasurer

NORTHERN ILLINOIS GAS COMPANY

By: 

Name: Karen K. Pepping  
Title: Vice President and Controller

BIRDSALL, INC.

By: 

Name: Gerald P. O'Connor  
Title: Treasurer

TROPIC EQUIPMENT LEASING INC.

By: 


Name: Gerald P. O'Connor  
Title: Vice President and Treasurer

TROPICAL SHIPPING AND  
CONSTRUCTION COMPANY LIMITED

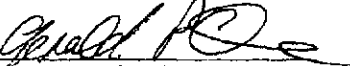
By:   
P. 4/18/01

Name: Richard Murrell  
Title: Chairman and President

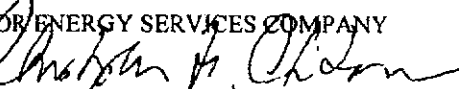
NICOR ENERGY VENTURES COMPANY

By:   
Name: Gerald P. O'Connor  
Title: Treasurer

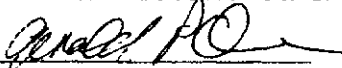
NICOR ENERGY MANAGEMENT  
SERVICES COMPANY

By:   
Name: Gerald P. O'Connor  
Title: President and Treasurer

NICOR ENERGY SERVICES COMPANY

By:   
Name: Christopher F. Childress  
Title: President


NICOR ENERGY SOLUTIONS INC.

By:   
Name: Gerald P. O'Connor  
Title: President and Treasurer


NICOR ENERCHANGE, L.L.C.

By:   
Name: Gerald P. O'Connor  
Title: Treasurer


NICOR HOME SERVICES, L.L.C.

By:   
Name: Christopher F. Childress  
Title: President

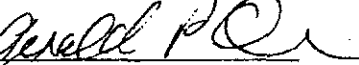
NICOR HORIZON, INC.

By:   
Name: Gerald P. O'Connor  
Title: President and Treasurer


NICOR OIL & GAS CORPORATION

By:   
Name: Gerald P. O'Connor  
Title: President and Treasurer


NICOR NATIONAL INC.

By:   
Name: Gerald P. O'Connor  
Title: President and Treasurer


NICOR MINING INC.

By:   
Name: Gerald P. O'Connor  
Title: President and Treasurer

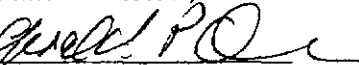
NICOR PURCHASING L.L.C.

By:   
Name: Gerald P. O'Connor  
Title: President and Treasurer

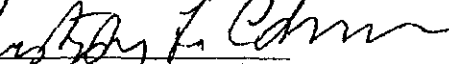
NICOR SOLUTIONS, L.L.C.

By:   
Name: Christopher F. Childress  
Title: President

NI-GAS EXPLORATION, INC.

By:   
Name: Gerald P. O'Connor  
Title: President and Treasurer

PRAIRIE POINT ENERGY, L.L.C.

By:   
Name: Christopher F. Childress  
Title: President

IBT SOLUTIONS, L.L.C.

By: 

Name: Christopher F. Childress

Title: President

SEVEN SEAS INSURANCE COMPANY, INC.

By: 

Name: Gerald P. O'Connor

Title: Vice President and Treasurer

Revised  
March 17, 2008

Exhibit A

Parties to the Operating Agreement

NICOR Inc. (Parent)  
Northern Illinois Gas Company  
Birdsall, Inc.  
Tropic Equipment Leasing Inc.  
NICOR Energy Ventures Company  
NICOR Energy Management Services Company  
NICOR Energy Services Company  
NICOR Energy Solutions Inc.  
NICOR Enerchange L.L.C.  
NICOR Home Services, L.L.C.  
NICOR Horizon, Inc.  
NICOR Oil & Gas Corporation  
NICOR National Inc.  
NICOR Mining Inc.  
NICOR Purchasing L.L.C.  
NICOR Solutions, L.L.C.  
NI-Gas Exploration Inc.  
Prairie Point Energy L.L.C.  
IBT Solutions L.L.C.  
Tropical Shipping and Construction Company Limited  
Seven Seas Insurance Company, Inc.  
Cypress Creek Gas Storage, L.L.C.  
Central Valley Gas Storage, L.L.C.

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Northern Illinois Gas Company )  
d/b/a Nicor Gas Company )  
 ) Docket No. 08-0363  
Proposed general increase in rates, and )  
revisions to other terms and conditions )  
of service )

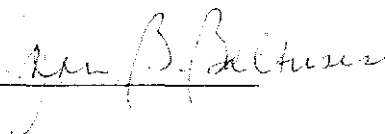
AFFIDAVIT

I, Gerald P. O'Connor, under oath, hereby swear to the following:

1. I am the Senior Vice President Finance and Strategic Planning of Nicor Gas Company;
2. I prepared prefiled Surrebuttal Testimony on behalf of Northern Illinois Gas Company, d/b/a Nicor Gas Company, submitted as Nicor Gas Ex. 46.0, including Exhibits 46.1 through 46.3, and filed on November 5, 2008;
3. I have personal knowledge of all the facts in my Surrebuttal Testimony, and the answers set forth therein are true and correct to the best of my knowledge; and
4. If asked those same questions today, my answers would be the same.

  
Gerald P. O'Connor

Subscribed and sworn to before me  
this 4<sup>th</sup> day of November, 2008.

  
Notary Public

